

REPORT OF EXAMINATION  
OF THE  
ESURANCE PROPERTY AND CASUALTY  
INSURANCE COMPANY

AS OF  
DECEMBER 31, 2008

Participating States  
and Zones:

California

Filed April 9, 2010

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San Francisco, California  
February 16, 2010

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Christina Urias  
Secretary, Zone IV-Western  
Director of Insurance  
Arizona Department of Insurance  
Phoenix, Arizona

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

#### ESURANCE PROPERTY AND CASUALTY INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 650 Davis Street, San Francisco, California 94111. The Company's statutory home office and main administrative office are also located at 650 Davis Street, San Francisco, California 94111.

#### SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2008. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2008, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees', and agents' welfare and pension plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

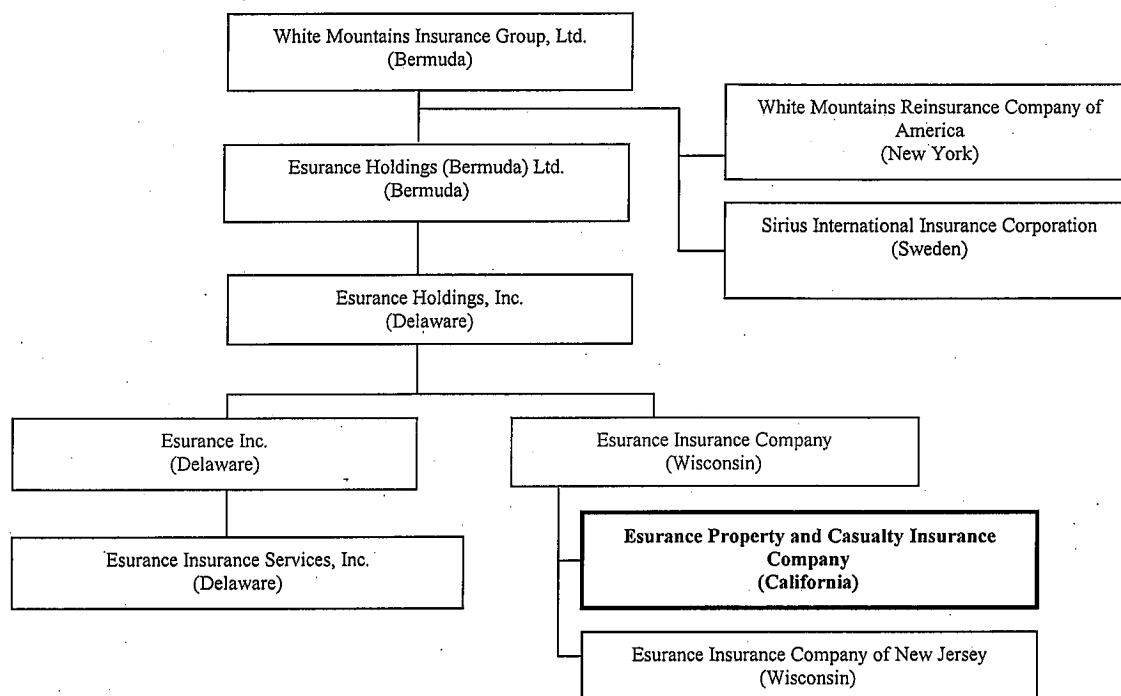
### COMPANY HISTORY

The Company received a capital contribution of \$5 million (cash) in December of 2007 from its parent, Esurance Insurance Company.

### MANAGEMENT AND CONTROL

White Mountains Insurance Group, Ltd., a Bermuda corporation, is the ultimate controlling entity of the Company. The Company is a stock corporation operating under the control of its sole shareholder, Esurance Insurance Company, and under the direction and management of its board of directors and officers.

The following is an abridged organizational chart depicting the Company within the holding company system:



Management of the Company is vested in a seven-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2008 follows:

### Directors

#### Name and Residence

Gary C. Tolman  
Mill Valley, California

Jonathan D. Adkisson  
San Rafael, California

Christopher M. Henn  
Corte Madera, California

Philip J. Swift  
Novato, California

#### Principal Business Affiliation

President and Chief Executive Officer  
Esurance Holdings, Inc.

Managing Director and Treasurer  
Esurance Holdings, Inc.

Managing Director  
Esurance Inc.

Managing Director  
Esurance Inc.

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
John C. Swigart McLean, Virginia	Managing Director Esurance Inc.
Wayne A. Sharrah Rocklin, California	Vice President Esurance Inc.
Kerian Bunch Larkspur, California	Vice President and Secretary Esurance Holdings, Inc.

#### Principal Officers

<u>Name</u>	<u>Title</u>
Gary C. Tolman	President and Chief Executive Officer
Kerian Bunch	Vice President, Secretary and General Counsel
Jonathan D. Adkisson	Vice President, Treasurer, Actuary and Chief Financial Officer
David M. Biewer	Vice President
Toby A. Grist	Vice President
Christopher M. Henn	Vice President
Scott A. McCrae	Vice President
Wayne A. Sharrah	Vice President
Philip J. Swift	Vice President
John C. Swigart	Vice President
Richard G. Warren	Vice President
Sarah Ainslie	Assistant Secretary

#### Related Party Agreements

*Management Service Agreement:* The Company entered into an Insurance Management Service Agreement with Esurance Inc., effective January 1, 2003. The agreement was amended effective January 1, 2008 and provides for accounting, tax, audit, and functional support services, for a fee based on actual and reasonable expenses of Esurance Inc., not to exceed 6% of the Company's net earned premium. Prior to 2008, the fee was 8% of the Company's net earned premium. The Company paid Esurance Inc. \$510,000, \$800,000, \$1,353,000 and \$1,208,000, in the years 2005,

2006, 2007, and 2008, respectively, under this agreement. The amendment was authorized by the California Department of Insurance (CDI) per California Insurance Code (CIC) Section 1215.5(b) (4) on April 11, 2008.

*Agency Agreement:* The Company entered into a managing general agent agreement with Esurance Insurance Services, Inc. (EISI), an affiliate, effective January 1, 2003. This agreement was authorized by the CDI on May 28, 2004. The agreement was amended January 1, 2004 and January 1, 2007. These amendments were authorized by the CDI on August 29, 2007. In accordance with the terms of the current agreement, the Company pays EISI for the policies written under the agreement, the lower of actual, fair and reasonable cost incurred by EISI or a 13.5% commission fee for premiums generated, net of returns and 100% of the actual loss adjustment expenses incurred by EISI. Prior to the 2007 amendment, the Company paid the actual acquisition costs incurred by EISI; a provisional loss adjustment expense commission of 10% of net premiums written; and a provisional loss adjustment expense commission of 3% of net premiums; and 100% of policy fees collected.

The following is a summary of agency and commission fees incurred by the Company under the terms of the agreements during the examination period:

<u>Year</u>	<u>Agency Fees</u>
2005	\$ 21,350,000
2006	29,580,000
2007	24,602,000
2008	<u>27,336,000</u>
Total	<u>\$102,868,000</u>

*Investment Management Agreement:* The Company entered into an Investment Management Agreement with OneBeacon Asset Management, Inc., now known as White Mountains Advisors LLC (WMA), effective July 1, 2002. Under this agreement, WMA provides investment management services, including the investment and reinvestment of the Company's investment

assets. The fee for these services is paid on a quarterly basis at rates applied to its investment portfolio. During the years ended December 31, 2005 through 2008, the Company incurred \$37,000, \$69,000, \$85,000, and \$138,000, respectively, for the services provided. The agreement was approved by the CDI on October 4, 2002.

*Tax Allocation Agreement:* The Company participated in a Tax Allocation Agreement dated December 1, 2001 with its previous parent, Fund American Enterprises Holdings, Inc. (FAEH) and affiliates (collectively “the Affiliated Group”) until December 18, 2004, when an updated agreement between FAEH and Esurance Holdings, Inc. and its subsidiaries (“EHoldings Affiliated Group”) was put into place. (Esurance Holdings, Inc. is the parent company of the Company’s parent, Esurance Insurance Company). The updated agreement provides for a separate consolidated tax filing for the EHoldings Affiliated Group and preserves the respective rights and obligations of the parties under the 2001 Tax Allocation Agreement. The updated agreement was also amended to delete FAEH from the agreement and is now between Esurance Holdings, Inc. and the direct and indirect subsidiaries of Esurance Holdings, Inc. The Company notified the CDI of the amendment and requested a filing exemption per 1215.5(i) on April 4, 2008. The CDI did not disapprove the exemption based on the clarification of the tax allocation arrangement.

*Assigned Automobile Risk Plan Agreements:* The Company has a Limited Assignment Distribution Agreement (LAD), effective April 27, 2007 and a Low Cost Automobile Insurance Agreement (LCA), effective January 1, 2007, with AutoOne Insurance Company (AutoOne), an affiliated company. The agreements authorize AutoOne to accept and service California automobile assigned risk policies under the LAD agreement and California low cost automobile insurance policies under the LCA agreement. The agreements were amended to be effective January 1, 2008. The CDI did not object to these agreements.

## TERRITORY AND PLAN OF OPERATION

The Company is licensed to write the following lines of business in California: automobile, boiler and machinery, burglary, common carrier liability, fire, liability, marine, miscellaneous, plate glass, sprinkler, surety, and worker's compensation.

At December 31, 2008, the Company was licensed to transact business in 41 states and the District of Columbia. The Company was not licensed in the States of: Alaska, Delaware, Idaho, Massachusetts, New Hampshire, New Jersey, New Mexico, North Carolina, and Wyoming.

The Company currently writes only private passenger auto liability insurance and auto physical damage in the States of California and Minnesota. In 2008, the California book of business represented 95% of the Company's business. In 2009, the Company began writing business in Arizona, Georgia, and Ohio.

The Company utilizes its affiliated managing general agent, Esurance Insurance Services, Inc. (EISI), to sell its personal automobile products. EISI markets the Company's products directly through its website and over the phone. The Company also sells its product through EISI's Partner Agencies which utilize the internet and other traditional insurance channels. The 66 agents currently appointed by the Company include both employees of EISI and its partner agencies.

In 2008, the Company ceded 90% of its business to its parent, Esurance Insurance Company. The following is a summary of the direct and net written premium per year by the Company during the examination period:

Year	Direct	Net
2005	\$ 68,650,714	\$ 6,862,736
2006	116,273,273	11,627,327
2007	184,052,522	20,037,303
2008	204,760,795	22,523,459

## REINSURANCE

### Assumed

The Company did not assume business during the examination period.

### Ceded

Effective January 1, 2008, the Company entered into a 90% quota share reinsurance agreement with Esurance Insurance Company (EIC) which replaced the previous (2004) 90% quota share agreement. Under the terms of the new reinsurance agreement, the Company cedes 90% of its premium and losses to EIC in exchange for a ceding commission equal to the actual acquisition expenses paid in obtaining the book of business. The 2008 agreement was approved by the California Department of Insurance on July 1, 2008.

As of December 31, 2008, reinsurance recoverables on paid and unpaid loss and loss adjustment expenses and unearned premiums totaled \$64.8 million, or 197% of the Company's surplus as regards policyholders. The entire recoverable was due from Esurance Insurance Company under the terms of the quota share agreement.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2008

Underwriting and Investment Exhibit for the Year Ended December 31, 2008

Reconciliation of Surplus as Regards Policyholders from December 31, 2004  
through December 31, 2008

Statement of Financial Condition  
as of December 31, 2008

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Note</u>
Bonds	\$ 40,292,977	\$	\$ 40,292,977	
Cash and short-term investments	28,963,436		28,963,436	
Receivable for securities	16,691		16,691	
Investment income due and accrued	388,252		388,252	
Premiums and considerations:				
Uncollected premiums and agents' balances in course of collections	9,356,783	114	9,356,669	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	13,146,897		13,146,897	
Reinsurance amounts recoverable from reinsurers	10,223,087		10,223,087	
Net deferred tax asset	809,864	20,195	789,669	
Receivable from parent, subsidiaries and affiliates	<u>637,256</u>		<u>637,256</u>	
Total assets	<u>\$103,835,243</u>	<u>\$ 20,309</u>	<u>\$103,814,934</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 5,507,973	(1)
Loss adjustment expenses			1,207,284	(1)
Other expenses			2,175	
Taxes, licenses and fees			1,047,450	
Current federal and foreign income taxes			1,051,255	
Unearned premiums			4,884,402	
Advance premium			2,781,587	
Ceded reinsurance premiums payable			49,773,540	
Payable to parent, subsidiaries, and affiliates			<u>4,731,093</u>	
Total liabilities			\$70,986,759	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		12,566,892		
Unassigned funds (surplus)		<u>17,661,283</u>		
Surplus as regards policyholders			<u>32,828,175</u>	
Total liabilities, surplus, and other funds			<u>\$103,814,934</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2008

Statement of Income

Underwriting Income

Premiums earned		\$ 22,400,143
Deductions:		
Losses incurred	\$ 11,796,674	
Loss expense incurred	2,020,170	
Other underwriting expenses incurred	<u>4,476,833</u>	
Total underwriting deductions		<u>18,293,677</u>
Net underwriting gain		4,106,466

Investment Income

Net investment income earned	\$ 2,242,995	
Net realized capital loss	<u>(372,425)</u>	
Net investment gain		1,870,570

Other Income

Finance and service charges not included in premiums	<u>\$ 5,831,770</u>	
Total other income		<u>5,831,770</u>
Net income before federal income taxes		11,808,806
Federal income taxes incurred		<u>4,275,751</u>
Net income		<u>\$ 7,533,055</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 25,153,427
Net income	\$ 7,533,055	
Change in net unrealized capital gains less capital gains tax	10,952	
Change in net deferred income tax	150,604	
Change in nonadmitted assets	<u>(19,863)</u>	
Change in surplus as regards policyholders for the year		<u>7,674,748</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 32,828,175</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2004 through December 31, 2008

Surplus as regards policyholders, December 31, 2004,  
per Examination

\$ 13,925,038

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$12,702,865	\$	
Change in net unrealized capital gains	28,980		
Change in net unrealized foreign exchange capital loss		871	
Change in net deferred income tax	902,890		
Change in nonadmitted assets	140,708		
Change in provision for reinsurance	128,565		
Surplus adjustments: Paid-in	<u>5,000,000</u>		
Totals	<u>\$18,904,008</u>	<u>\$ 871</u>	
Net increase in surplus as regards policyholders for the Examination period			<u>18,903,137</u>
Surplus as regards policyholders, December 31, 2008, per Examination			<u>\$ 32,828,175</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary for the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2008 were found to be reasonably stated and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

The current report of examination has no comments or recommendations.

### Previous Report of Examination

The previous report of examination had no comments or recommendations.

### ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

\_\_\_\_\_  
/s/

Sandra Bailey, CFE  
Examiner-In-Charge  
Department of Insurance  
State of California